

CGV IN CHINA

HYUNMIN LEE & SEUNGHO CHOI

Department of Business Administration, Ewha Womans University, Seoul, South Korea, Asia

ABSTRACT

CJ CGV entered into the Chinese cinema market in 2006 by establishing a joint venture with Shanghai Film Group (SFG), which is a subsidiary of Shanghai Media & Entertainment Group. CGV entered into Chinese market with the strategy to make CGV the hub of Korean culture. However, CGV is struggling in the market is due to the loss of its original market, which is a main strategic issue of CGV in China. To solve this strategic issue, cinematization can be an effective way for CGV to acquire exclusive contents competitive in Chinese niche market. Also, CJ E&M should make close strategic alliance with Chinese firms to produce sufficient and adequate Korean contents.

KEYWORDS: CGV, China, Acquisition, Film Industry

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INTRODUCTION

COMPANY OVERVIEW

History Overview of CJ CGV

From the foundation of the brand, CJ had been a part of Samsung until 1993. However, after Lee Byung-chul passed away in 1987, there was the first arrangement of Samsung's subsidiaries among Lee's family in 1993 and CJ became independent from Samsung after the arrangement. After its independence from Samsung, CJ has aggressively diversified its business into media, entertainment, finance and information & communication businesses. To expand its business into entertainment, CJ established subsidiaries such as Cheil Golden Village, the ancestor of CGV, with Orange Sky Golden Harvest of Hong Kong and Village Roadshow of Australia in 1996. Starting from CGV Kang-byun in 1998, CGV was the first company in Korea to introduce multiplex, a movie theater complex with multiple screens, typically more than one screen within a single complex. The company has become the no.1 in Korean cinema industry by providing differentiated services and locating its theaters in places with a large population. In addition to CGV, CJ E&M Corporation (CJ E&M) is another subsidiary of CJ's Entertainment and Media department. In 2010, the media department of CJ O-Shopping was divided into O-Media holdings. In the same year, it went public to Kosdac. And in 2011, O-Media holdings changed its name into CJ E&M. In march 2011, it took over 5 media subsidiaries within CJ; On Media, CJ Media, CJ Internet, Mnet Media and CJ entertainment. After M&A, departments were reorganized into four parts; media, film, music and live entertainment. Under CJ E&M, there are four parts; media, film, music and live entertainment. Media part started from the music channel Mnet in 1993. Now it has 18 channels like tvN, Mnet, OCN and etc., and most of its programs have high view rate due to the creative contents that attract people. Film part deals with planning, production and distribution.

CGV in China

CJ CGV entered into the Chinese cinema market in 2006 by establishing a joint venture with Shanghai

Film Group (SFG), which is a subsidiary of Shanghai Media & Entertainment Group. Its first theater in China was established in Daning, Shanghai in 2006. In 2011, CJ CGV acquired shares of UVD Enterprise in Hong Kong, which made it possible for CGV to gain 100% of shares in CGV movie theaters in China, due to UVD having Closer Economic Partnership Agreement (CEPA) license which allows independent management in China. Since its first opening in Shanghai, CGV expanded its sites aggressively. However, its increase rate of theaters was relatively slow compared to its competitors. After its first cinema in Shanghai, CGV opened its second movie theater in Xinzhuang in 2009. As of January, 2015 CGV operates 38 cinemas and 300 screens in China in Shanghai, Beijing, Chengdu etc. In spite of the rapid growth of Chinese cinema industry, CGV has struggled to generate profits in China. CGV in China lost 1.5 billion won in the first period of 2014 and 5.1 billion won in the second period. However, CGV's market share in China has been growing due to the increase in the number of theaters. In 2015, CGV ranked 10th place, jumped up from 14th in 2013 and 35th in 2009. CGV plans to have more than 100 cinemas until 2016 by investing 200 billion won.

Chinese Cinemas Market Share in 2013

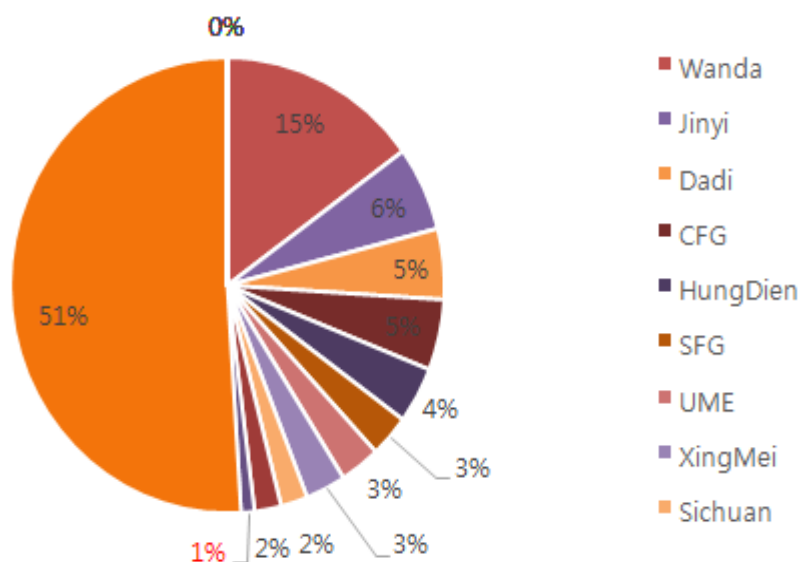


Figure 1: Chinese Cinemas Market Share in 2013

STRENGTHS AND OPPORTUNITIES

Strengths

Abundant Know-How on Cinema Industry

CGV adapted the high-end technology in order to improve the quality of cinemawatching. It also provides differentiated experience to customers by introducing premium cinemas like Gold-Class, Cine de Chef and Sweet-Box. CGV has abundant knowledge on how to run cinema business. It has been continuously expanding its market share and stayed as a leading company in Korean market. CGV has built high quality brand image by introducing advanced cinema technique and service. Improvement in technology and service has increased customer loyalty along with the strong brand image and increased market share. CGV had 48.2% of the market share, which was only 18.6% in 2002. The experience, came through the competitive market, would be useful for CGV to survive from Chinese market.

Korean Market as a Cash Cow

CGV can use Korean market as a cash cow for investing Chinese market as Korean market is making stable profit. To enter cinema business, it requires much capital. Due to this, CGV in China is still in deficits yet. But the reason why CGV is able to aggressively expand its sites in China is the capability to bring cash from stable Korean market. Domestic ticket prices have been suppressed since 2009, due to government pressure, despite no regulatory approval requirement for price hikes. But, from 2014, three leading Korean theater players (CGV, Lotte and Megabox) have fully implemented a new pricing policy 2014 differentiating ticket price. Under this new strategy, they have lowered the premium film prices (e.g., 3D, 4D, and IMAX), and raised the price of 2D films which account for most of their sales. CGV has expanded the strategy to entire sites since February 2014. So far, the new pricing scheme has been successfully implemented without resistance.

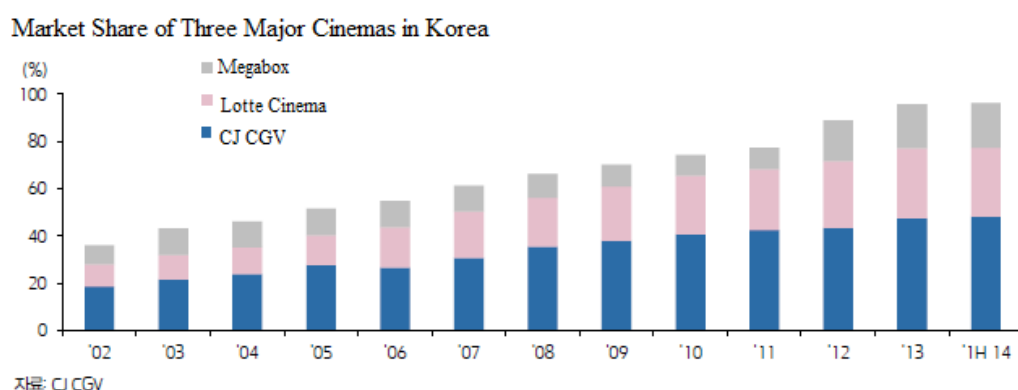


Figure 2: Market Share of Three Major Cinemas in Korea

Vertical Integration

Through producing, distributing and screening films, CJ entertainment maximizes its profit through vertical integration. CJ's film business first started as a distribution and marketing of DreamWorks' movies in 1995. But, the number of movies that DreamWorks made in a year was about 5~6 which was not enough for CJ to make profit from movie distribution. Due to this, CJ turned its eyes to screening films. CJ decided to adopt multiplex, and this was the start of CGV, first Korean multiplex. After CJ opened CGV, CJ aggressively acquired rights for distribution through strategic alliance with Korean movie making companies such as Myung Film.

Imax Cinemas

To provide Chinese for a premium services, CGV plans to increase the portion of IMAX cinemas in China. Total number of IMAX in China is nearly 140. The existing IMAX shares of CGV are 20%, following Wanda which has 39% of the IMAX share. The reason why CGV aggressively expands IMAX cinema is the popularity of IMAX among Chinese. For IMAX, China is the fastest growing market in the world. In 2013, more than half of the \$2.7 billion came from foreign films, with three IMAX movies topping the popularity roster—an indication that the increasingly sophisticated Chinese consumers desire not simply entertainment, but more world-class products. Considering this popularity of IMAX, having 20% of IMAX shares is a competitive advantage of CGV. Except for Wanda and Shanghai Film Group, other competitors are not enthusiastic in making contracts with IMAX so CGV is expected to fully enjoy the popularity.

OPPORTUNITY

The Korean Wave

As Korean wave gets stronger, export of Korean media contents to foreign countries increases. Korean wave Generation 1.0 is based on Korean dramas and image contents, and it started in 1997, when the first Korean TV drama *What Love is All About* was broadcast in CCTV. Subsequently in year 2000, China had 24 Korean dramas broadcasted on TV. Since then, Korean contents' export to China and other Asian countries is continuously increasing. The popularity even appeared in politics in 2005, when Chinese president Hu Jintao mentioned that he watches Korean drama *Dae Jang Geum* when he met South Korean president Lee. Generation 2.0, is based more on K-pop, idol stars such as Super Junior, Girls' Generation, Kara. K-POP's overall export also had an annual increase rate of 35% from 2008 to 2010 (2011, Contents Industry Statistics). The amount of Korean music contents' export to China increased from 1.844 million in 2008 to 3.627 million dollars in 2010, a 196 percent increase in two years.

Change in Chinese Cinema Industry

Chinese cinema market has been developed into a current system which unifies production, distribution and screening after a change in Chinese government's policy in 2002. To develop cinema industry, Chinese government started to allow private firms to run movie distribution and production which had been wholly monopolized by national enterprise. Through this, China was able to increase investment on cinema industry. In distribution and circuit part, China introduced WonSonJae (院線制) to simplify the distribution process. If a movie is acknowledged as a co-produced one, the movie can avoid the limitation of quota system and be released as a Chinese film. Through this new policy, the film co-producing market has grown up in three times in just five years. The size of co-production market was 2.3 billion yuan in 2009 and it increased to 7.1 billion yuan in 2013. Especially, due to Korea-China FTA, CGV can expect to increase screenings of Korean films. Under the quota system, only 2 or 3 Korean films were able to be screened annually in China. But, through FTA, if Chinese firms invest 20% to Korean films, those movies will be considered as Chinese films so the numbers of Korean movies in China are expected to increase.

Table 1: Percentage of Illegal Distribution of Korea Dramas and Movies in China

	Percentage of Illegal Distribution		Number of Sites
	Movie	Drama	
2007	88%(2,059)	91%(497)	59
2008	90%(462)	76%(415)	59
2009	76%(523)	-	77
2010	78%(691)	33%(495)	28
2011	68.1%(781)	24.7%(543)	28

Source: Korean Copy Right

Chinese Cinema Industry

Cinema industry in China is growing rapidly with expected potential as well. China has enormous land area with a large population, but cinemas have not reached enough yet. The number of screens per one million people in China is 9.7 in 2012, while it is 127 cinemas in U.S., and 42 cinemas in South Korea. Also, as shown in the graph (Figure N), Chinese watch average 0.35 movies per year in 2012. It is a low number compared to people in U.S. or South Korea who watch about 4 movies in average. Cinema industry in China has definite potential in terms of quantity. Although Chinese film and media industry seems still insufficient, it is actually booming as it is in the growth stage. In 2009, Chinese movie market grew 43%,

RMB 6.206 billion of film box office. In 2010, the box office in China exceeded RMB 4.8 billion, rising 107% from that of the same period in 2009. Following 2010, the number of screens and import of movies have also increased (Figure N). Pricewaterhousecoopers (PwC), a multinational professional services network, also projects that the industry will be worth \$6.49 billion in 2017, which used to be \$3.26 billion in 2012. China will become the largest film and media market in the world in the next couple of years.

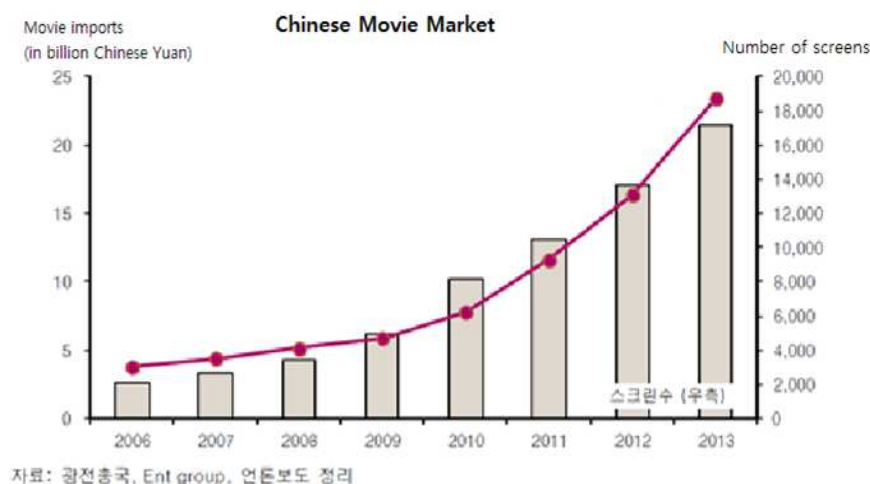


Figure 3: Chinese Movie Market

Competitor Analysis

Wanda

Wanda Cinema was established in 2005 as a subsidiary of Wanda Group, a Chinese company which has its business in real estate, hotels, tourism, and entertainment area. Wanda Cinema is one of the leading companies in Chinese cinema industry, the largest movie theater operator in China. The market share of Wanda from January to August of 2013 was 14.6%, which was the highest and this percentage was more than double of Jinyi following Wanda at 5.9%. As of 2014 Wanda owns 149 cinemas in China with a total of 1,247 screens, 89 of which are IMAX screens. Wanda's revenue in 2013 was \$515 million with net profit of \$98.5 million. Wanda Cinema was able to grow at a fast speed because of the preoccupied cities. Wanda entered into the commercial real estate market in China in the mid- 2000s, and the fast growth of the commercial real estate market brought Wanda Cinema a high market share. About 60% of Wanda cinemas are located at malls owned by Wanda Group. For Wanda Cinema, being a part of a mall owned Wanda is beneficial since it requires less capital investment.

Jinyi International Cinema

Since its establishment on March 1, 2004, Guangzhou Jinyi Film & Television Media Co., Ltd. (formerly called Guangzhou Jinyi Film & Television Investment Group Co., Ltd.) has continually been committed to the construction and operation of five-star, multiplex luxury theaters. On April 2008, Jinyi Film & Television Media restructured the former Guangdong Zhujiang Movie Circuit into its wholly-owned movie circuit, Jinyi Zhujiang Movie Circuit and commenced operations. Jinyi operates nearly 50 wholly owned theaters namely Jinyi International Cinemas in more than 30 cities including Guangzhou, Beijing, Shanghai among others with more than 300 screens. Jinyi owns another 19 franchised

theaters with approximately 100 screens, bringing its screen total to 400. According to the “2010 Chinese Film Market Review”, Jinyi Zhujiang Movie Circuit earned box office revenues of nearly RMB700 million in 2010, ranking it 6th among cinema chains nationwide. To attract customers, Jinyi made a contract with IMAX, and GDC technology, a world leading digital cinema solution provider, in 2011. Through the contracts, Jinyi expects an increase and differentiation in service.

China Film Stellar Film Chain

China Film Group (CFC), the most influential film corporation, became the largest shareholder of CFSF. CFC has the largest distribution network in Asia working with Sony pictures classic, Focus Features and Paramount pictures. As CFC distributes major foreign films, it has become much easier for CFSF to screen Hollywood films than its competitors. However CFC, being a state owned company, has a relatively conservative expansion plan. Thus CFSF is not able to increase its sites aggressively. In addition, as it manages all the value chain, the concentration on marketing its cinemas is low. To overcome this problem, CFC tries to obtain capital solely dealing with marketing its cinemas through IPO. Moreover, Baidu plans to invest on the firm with China International Trust and Investment Corporation (CITIC), an investment company run by Chinese government. To differentiate from its competitors, CFC plans to increase DMAX cinema exclusively made by itself. DMAX, invented by CFC and Chinese Science and Technology Laboratory(中國科學奇術研究所), is smaller than IMAX but has more clear vision. In addition, it tries to lower the ticket price by half of the price of IMAX. (The price of IMAX is 150RMB while that of DMAX is 40~80RMB.) The operation cost needed for management is cheaper as well as CFSG doesn't have to pay license to IMAX.

Shanghai Film Group Corporation

Shanghai Film Corporation is China's largest state-owned enterprise in the exhibition industry, with the second-largest exhibition market share in the country, and owns 100% of SUC along with a major share at its joint venture (SFG-EPR) with EPR, an entertainment REIT from Kansas City. It was the first company to open IMAX theater in 2004 in China. Through the contract with IMAX, the company's box office sale was increased by 50%. As one of the few companies which cover a complete chain of film distribution and exhibition, SFC perfectly combines a few roles as professional distributor, comprehensive cinema line and high-end theater operator. SFC is a leading company in both film distribution and exhibition businesses. Now it has over 200 affiliate complexes in 24 provinces with over 1000 screens and 11 IMAX screens. In 2013, SUC had box office of RMB 1.88 billion with an 8.6% share of China, making it runner-up in its peers.

Leading movie theater chains in China in 2013, by box office revenue (in million yuan)

The graph shows leading box office chains in China by revenue. In 2013, Wanda International Cinemas ranked first with revenues of about three billion yuan.

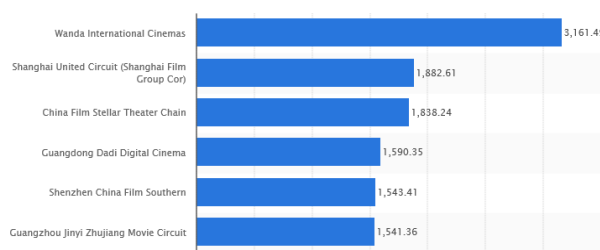


Figure 4: Leading Movie Theater Chains in China in 2013, by Box Office Revenue in Million Yuan

WEAKNESSES AND THREATS

Weaknesses

Even though the Chinese cinema industry has many attractive features, CGV faces some challenges. It does not have clear brand image in China. That was mainly because CGV was not using strategies to maximize its benefit from having easy access to Korean contents. And also CGV was not showing enough Korean films. Part of this problem is due to the worse performance of Korean films than Chinese films. As a result, differentiating CGV by showing more Korean films is not the optimal option for CGV. Moreover, CGV in China is not perceived as a brand with premium price strategy. Its ticket price is only 2 RMB higher than the average ticket price in China. In addition, CGV has cinema location problem. CGV announced that it is going to build more cinemas in second or third tier cities. Currently it owns 27 cinemas in second or third tier cities, but it will increase the number of cinemas to 200 by 2020. This decision was made because the competition in first tier cities like Beijing and Shanghai is too harsh so CGV decided to broaden their business location to second or third tier cities. However, as the graph above shows, most of its revenue is coming from first tier cities. In contrast, the revenue generated in second or third tier cities is relatively much lower.

Threats

In addition to its weaknesses, CGV has several threats. First, CGV's competitors in China have large capital. For example, Wanda, which is leading company of cinema industry in China with market share of 14.3%, starting their business at the real estate market in China. Based on their success in real estate market, they have been diversifying their business portfolio. Currently Wanda has activities in real estate, tourism, hotels, and entertainment. As of 2014, Wanda owns 88 Wanda Plazas, 55 five-star hotels, 1,247 cinema screens, 78 department stores, throughout China. With their diversified portfolio, Wanda has been creating synergy between different businesses that they own. For instance, 60% of Wanda's cinema is located in shopping mall that Wanda owns. Second, quota system in China is one of the important threats of CGV in China. Currently Chinese government allows only 34 imported films per year. And even within those 34 imported films, Korean films have very low percentage. In 2012, only 4 Korean films were released in China, while 25 US films were released in the same year. This is a threat to CGV because it limits the capability of CGV to introduce Korean films so it became hard to pursue its original strategy.

Strategic Issue of CGV

Based on the CGV's weaknesses and threats, the most important and urgent strategic issue of CGV was found out. It's that CGV's original strategy when they entered into Chinese cinema market, which is making CGV the hub of Korean wave is missing. As mentioned as a weakness of CGV, it is not utilizing its advantage; an easy access to Korean culture contents. There are three main reasons why CGV is not being able to pursue its original plan. First of all, Korean wave is mainly for TV dramas of K-pop, not for the movies. For instance, *Snowpiercer*, which is ranked top 2 in Korean market in 2013, only earned 7million RMB. This is a very poor performance compared to *The Monkey King*, a Chinese movie that used similar amount of budget with *Snowpiercer*, earned one hundred million RMB only on its opening day. The reasons why Korean films are struggling in Chinese market are that Chinese audience has different preference from Korean audience and Korean film has relatively light fan base in China. Second, recently Chinese film producing companies are hiring Korean stars to get benefits from the popularity of Korean wave. Indeed, some of the Chinese movies with Korean stars are successful. For example, Song Hye-kyo, who is one of the most famous Korean actresses, acted the main role of the movie *The Crossing*. It was released on Dec 2, 2014 and on the first day of release, it earned

thirty million RMB and ranked no.1 at Chinese box-office. Lastly, as mentioned as a CGV's threat, quota system in China limits CGV's original strategy. Since only less than 5 Korean films are released in China annually, it is hard to differentiate their brand in terms of contents for CGV.

SOLUTION CINEMATIZATION AND JOINT FILMS

Cinematization

Cinematization is the production activity adapting novel, drama or other forms of creative work into movies. It is a common production method in these days especially in US and Japan. Cinematization can be an effective way for CGV to acquire exclusive contents competitive in Chinese niche market. The movies which are cinematized from the drama often score high box office hit. Many of them were exported to other countries as well. There are three main factors. First of all, the producers including actors, writers, and staffs can work efficiently because they got path dependency. They have built up their own rules internally so the rework is done with high quality and high speed. Even though some conditions or group members have changed, they already have either visible or invisible system to share intangible knowledge. It makes the producers efficient than the competitors, who are just managed as a team to produce a new movie. Secondly, it can easily get attention from public for being heard on regular basis. When the drama is cinematized, it is premised that the certain level of popularity of the original work. So the promotion is, to say, already half-done compared to the new piece of work without former success. Thirdly, it is guaranteed to be successful by drama fans in terms of the actual ticket sales. There are plenty of examples of well talked-about movies without coincided ticket sales. Fans of the original drama, however, will become the solid basic target group, because they are willing to pay money for the diversified version of the creation of same story line with different forms. In order to produce cinematized movies, CGV has to get help from CJ E&M, its holding company. As mentioned previously CJ E&M has a number of subsidiaries in entertainment business with extensive depth and width. The major two companies would be helpful to cinematize the movies for CGV. The tvN, the TV channel with various types of shows including drama, has a lot of popular series of drama ready to be cinematized. With the original work in hand, production process can have easy access to copyrights, which normally takes huge part in cost and conflict of the production. CJ Entertainment, the film production company, is the actual producer of the movies. And there are a lot of other channels which can elastically help the production and distribution. Within the group, there are better ways to share resources and capabilities, and they can make synergy.

Joint Films

It is recommended to have more cooperative strategy for CGV's international business in China. To be specific, CJ E&M should make close strategic alliance with Chinese firms to produce sufficient and adequate Korean contents. CGV can produce Korean-Chinese joint films by taking advantage of its strengths and opportunities. By using this partnership, more qualified Korean contents will be produced with combination between mutual synergy effect and more number of Korean contents will be released in recent Korea-China alliance relationship change. CGV can pre-release these contents much earlier than competitors and, eventually, can be differentiated cinema as 'Hub of Korean wave' in China. In terms of strengths, joint films can make synergy from combining Korea's contents and China's capital power. Korea, as mentioned before, has outstanding contents such as producing ability, creativity, attractive actors (e.g. Kim Soo Hyun or Lee Min Ho) etc. On the other hand, China has enormous capital strength. In fact, there is another Chinese company named POLYBONA which is already in strategic alliance with CJ E&M in 2010. They agreed for producing at least 2 joint films per year. However there was no outstanding cooperation between two companies so far. POLYBONA is also one of the

largest private producing companies in China, so CJ E&M should have more cooperation with it and produce more joint films. Instead, risks of strategic alliance should be considered. To be specific, they need to define clear strategy supported by both partners and clear understanding of capabilities and resources that will be central to the partnership. Also, they should trust each other and make mutual supplementary relationship.

CONCLUSIONS

The reason why CGV is struggling in the market is due to the loss of its original market, which is a main strategic issue of CGV in China. CGV entered into Chinese market with the strategy to make CGV the hub of Korean culture. To solve this issue, rather than focusing on increasing the number of sites, CGV should focus on its original strategy. By effectively using its strength and opportunity, CGV will be able to survive and take the favorable position in Chinese market. Manufacturing of its films such as cinematized films of popular Korean drama and joint films made by Korean people and Chinese capital and pre-releasing them will be the solutions because these are the ways that CGV can emphasize the image of Korean culture.

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Seungho Choi is a corresponding author (Tel: +82-2-3277-4138, choise@ewha.ac.kr)

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